

## Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-03  
INR-07 NSAE-00 USIA-06 XMB-02 OPIC-03 SP-02  
LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-04 CEA-01  
PA-01 PRS-01 EURE-00 L-03 /085 W  
-----231344Z 054715 /50

P 231237Z MAR 77  
FM AMEMBASSY LONDON  
TO TREASURY DEPT WASHDC PRIORITY  
SECSTATE WASHDC 1851

C O N F I D E N T I A L SECTION 01 OF 02 LONDON 04791

E.O. 11652: XGDS-1  
TAGS: EFIN, UK  
SUBJECT: U.K. TREASURY MINISTER ON BACKGROUND TO BUDGET,  
INCOMES POLICY, AND HM TREASURY ORGANIZATION

REF: LONDON 3559

SUMMARY: HM TREASURY FINANCIAL SECRETARY JOEL BARNETT REPORTS THAT THE OVERRIDING CONSIDERATION IN PREPARATION OF THE MARCH 29 BUDGET HAS BEEN THE NEED TO SECURE COOPERATION OF THE UNIONS IN THE THIRD STAGE OF INCOMES POLICY. TO BE FULLY UNDERSTOOD, THE BUDGET PRESENTATION MUST BE CONSIDERED IN THIS LIGHT. WHEREAS BOTH INCOMES AND PRICE CONTROL POLICIES MAY MAKE DECREASING SENSE IN ECONOMIC TERMS, THEY ARE ESSENTIAL TO THE LABOR GOVERNMENT IN A POLITICAL SENSE. DESPITE PM CALLAGHAN'S DESIRE TO SPLIT OFF TREASURY PUBLIC EXPENDITURE FUNCTIONS INTO AN OMB TYPE FUNCTION, CHANCELLOR HEALEY DEMANDS THAT THIS NOT HAPPEN AS LONG AS HE REMAINS AS CHANCELLOR. THIS WAS A CONDITION FOR HIS STAYING ON IN THE JOB. END SUMMARY.

1. FINANCIAL ATTACHE AND EMBASSY'S FINANCIAL ECONOMIST HAD LENGTHY LUNCHEON CONVERSATION WITH JOEL BARNETT, A  
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MEMBER OF THE CABINET AND FINANCIAL SECRETARY AT HM TREASURY. IN REPLY TO OUR QUESTIONS, HE WAS CIRCUMSPECT ABOUT SPECIFIC CONTENTS OF NEXT WEEK'S BUDGET BUT STRESSED THAT IN THE EVENT LABOR GOVERNMENT SURVIVED THE MARCH 23 VOTE OF CONFIDENCE, THE MARCH 29 BUDGET WOULD HAVE TO BE SEEN AGAINST A BACKGROUND OF THE NEED TO CONCLUDE A THIRD YEAR PAY DEAL. THUS, THE DETAILED TAX CHANGES WHICH WILL BE

PROPOSED WILL DIFFER FROM WHAT THEY OTHERWISE WOULD HAVE BEEN. DIRECT TAXES WILL BE CUT. BUT NOT AS SHARPLY IN TOP BRACKETS AS HEALEY AND BARNETT WOULD HAVE LIKED. IT WOULD NOT BE UNDERSTOOD BY LABOR'S POLITICAL SUPPORTERS. MAKING A SHIFT FROM DIRECT TO INDIRECT TAXATION IS COMPLICATED, SINCE EVERY 1.0 BILLION POUND INCREASE IN INDIRECT TAXATION ADDS 2.0 PERCENT TO THE ANNUAL RATE OF RETAIL PRICE INFLATION. BARNETT ADDED THAT THE INCIDENCE OF INDIRECT TAX INCREASES WAS VERY IMPORTANT TO CONSIDER. A RISE IN THE EXCISE TAX IN TOBACCO, FOR EXAMPLE, WOULD HIT PENSIONERS VERY HARD. MOREOVER, THE TUC WERE ASTUTE WAGE BARGAINERS AND WERE AWARE THAT INDIRECT TAX CHARGES WOULD SHOW UP VIRTUALLY IMMEDIATELY IN THE RPI WHILE INCOME TAX CUTS WOULD NOT SHOW UP FOR A PERIOD OF TWO MONTHS AFTER THE BUDGET.

2. BARNETT DID NOT GIVE ANY DETAIL OF THE SHAPE OF THE PLANNED TAX PACKAGE BUT DID STATE THAT HM TREASURY'S LATEST ESTIMATE WAS THAT A CUT OF 1.7 BILLION POUNDS WOULD BE NEEDED TO OFFSET THE FISCAL DRAG WHICH HAS BUILT UP SINCE THE BEGINNING OF FY 76. HE ADDED THAT THE TORIES MIGHT TRY TO CAPITALIZE ON ANY CUT THAT WAS SMALLER THAN THIS BY CLAIMING LABOR HAD NOT OFFSET THE EFFECTS OF INFLATION. FORTUNATELY, THIS CLAIM WOULD NOT BE UNDERSTOOD BY THE MAN IN THE STREET WHO WAS ONLY CONCERNED WITH THE SIZE OF HIS TAKE-HOME PAY.

3. TURNING TO CONTROL OF PUBLIC EXPENDITURE, BARNETT CONFIRMED THAT THE SYSTEM OF CASH LIMITS HAD SUCCEEDED  
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BEYOND EXPECTATIONS IN IMPROVING DAY-TO-DAY MONITORING OF ACTUAL OUTLAYS. SPENDING DEPARTMENTS WERE NOW ERRING ON THE SIDE OF CAUTION. THE RESULT WAS THAT THE VOLUME OF PUBLIC EXPENDITURE DURING FY 76 WOULD BE BELOW THE FORECAST. FISCAL POLICY DURING THE YEAR WOULD BE SEEN TO BE TIGHTER THAN INTENDED. NEXT TUESDAY'S BUDGET WILL SHOW CONSIDERABLE REDUCTIONS IN THE FORECAST PSBR FOR FY 1976/77.

4. WE ASKED, IF LABOR LOST THE MARCH 23 VOTE OF CONFIDENCE, WOULD THE BUDGET -- WHICH WILL BE PRESENTED IN ANY CASE -- CONTAIN ANY ADDITIONAL ELECTORAL SWEETENERS? BARNETT REPLIED NO, THIS WOULD BE TOO BLATANT AND COULD BE COUNTERPRODUCTIVE. "BUT WE MIGHT REMOVE SOME OF THE NASTY BITS."

5. BARNETT SAID THAT REGARDLESS OF THE OUTCOME OF THE VOTE OF CONFIDENCE, NO CONTROVERSIAL FINANCIAL LEGISLA-

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C O N F I D E N T I A L SECTION 02 OF 02 LONDON 04791

TION CAN BE INTRODUCED IN THIS SESSION OF PARLIAMENT  
WITH ANY EXPECTATION OF GETTING IT PASSED. THIS HAS BEEN  
THE CASE FOR SOME MONTHS NOW. AND CIVIL SERVANTS FINALLY  
APPEAR TO UNDERSTAND THIS.

6. TURNING TO INCOMES POLICY, BARNETT SAID THAT THERE  
HAD BEEN A MEETING MARCH 19 AMONG HMG AND THE 6 TRADE  
UNION LEADERS REPRESENTED ON THE NEDO COUNCIL. THEY WERE  
MORE AMENABLE TO A THIRD ROUND PAY DEAL THAN BEFORE. THE  
SUDDEN POSSIBILITY OF A GENERAL ELECTION SEEMED TO HAVE  
CONCENTRATED THEIR THINKING ON WAGE RESTRAINT. BARNETT  
BELIEVED THAT A DEAL RESULTING IN A RISE OF 10 PERCENT  
IN AVERAGE EARNINGS IN THE 12 MONTHS THROUGH AUGUST 1978  
WAS WITHIN THE RANGE OF POSSIBILITY. IN HIS VIEW, BOTH  
INCOMES POLICY AND PRICE CONTROLS WERE MORE POLITICAL  
THAN ECONOMIC IN NATURE. AT ONE POINT HE QUESTIONED THE  
ECONOMIC NEED FOR THEM; SAYING, FOR EXAMPLE ' MAXIMUM WAGE  
NORMS RAPIDLY BECOME THE MINIMUM NORMS. HOWEVER, FOR  
THIS GOVERNMENT. THEY ARE A POLITICAL NECESSITY. THERE.  
FORE, A THIRD YEAR OF WAGE RESTRAINT WAS ABSOLUTELY ES-  
SENTIAL TO MAINTAIN THE LABOR GOVERNMENT'S CREDIBILITY  
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WITH BOTH NATIONAL AND INTERNATIONAL OPINION.

7. WITH REGARD TO PRICE CONTROLS, BARNETT WAS SORRY THAT JACK JONES FLOATED THE IDEA OF A PRICE FREEZE SEVERAL WEEKS AGO. THIS RAISED FALSE EXPECTATIONS AND HAD MADE DISCUSSIONS WITH INDUSTRY ABOUT THE EXTENSION OF PRICE CONTROLS EVEN MORE DIFFICULT. IN FACT, THE CABINET WOULD BE DECIDING LATER IN THE DAY WHETHER THE EXTENSION OF PRICE CONTROLS WOULD BE MADE PERMANENT OR LIMITED TO A SPECIFIC PERIOD. HE ADDED THAT DI  
HATTERSLEY'S POSITION AS CABINET SECRETARY FOR PRICES AND CONSUMER PROTECTION IN HAVING TO MAKE THE CASE FOR CONTROLS.

8. BARNETT SAID THAT PM CALLAGHAN DID WANT TO SPLIT OFF HM TREASURY'S PUBLIC EXPENDITURE ROLE INTO AN OMB TYPE OPERATION. BARNETT HAD AN OPEN MIND ON THE QUESTION WHEN HE FIRST CAME TO TREASURY THREE YEARS AGO. BUT HE HAS SINCE BEEN CONVINCED THAT SUCH A SPLIT WOULD ADD TO THE CHANCELLOR'S WORK LOAD BECAUSE OF DIVIDED RESPONSIBILITY AND THE NEED FOR INCREASED COORDINATION.

9. CALLAGHAN RAISED THE ISSUE WITH BOTH HEALEY AND BARNETT AT THE TIME OF THE LATE FOREIGN MINISTER'S DEATH. HEALEY, WHO HAS CONSISTENTLY OPPOSED THE IDEA, TOLD CALLAGHAN THAT ONE OF HIS CONDITIONS FOR STAYING ON AS CHANCELLOR (RATHER THAN SHIFTING TO THE FOREIGN OFFICE) WAS THAT THE CONTROL OF THE PUBLIC EXPENDITURE FUNCTION SHOULD REMAIN FIRMLY IN THE TREASURY. FOR THE MOMENT AT LEAST HEALEY HAS HAD THE LAST WORD.

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## Message Attributes

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